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No. 89-1037

In the Supreme Court of the United States

OCTOBER TERM, 1989

XEMAS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
Solicitor General
SHIRLEY D. PETERSON
Assistant Attorney General
WILLIAM S. ESTABROOK
LINDA E. MOSAKOWSKI
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 633-2217

QUESTIONS PRESENTED

1. Whether the IRS's levy in this case was wrongful because the seizure occurred more than six years after the taxpayers made a fraudulent conveyance of the property and Minnesota law establishes a six-year statute of limitations for commencing a suit to set aside a fraudulent conveyance.

2. Whether the IRS was required to seize the property in this case by some means other than an administrative levy.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-3a) is unpublished, but the decision is noted at 889 F.2d 1091 (Table). The opinion of the district court (Pet. App. 6a-18a) is reported at 689 F. Supp. 917.

JURISDICTION

The judgment of the court of appeals was entered on July 24, 1989. A petition for rehearing was denied on September 20, 1989 (Pet. App. 4a-5a). The petition for a writ of certiorari was filed on December 19, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Roman and Imelda Spaeth, who are husband and wife, have engaged in various activities designed to prevent the collection of their federal income taxes since December 1977 when they became "ministers" in the Basic Bible Church of America (Pet. App. 11a, 12a). By a warranty deed dated December 28, 1978, the Spaeths transferred title in their residence to Joan Noske as trustee of Chapter 7024 of the Basic Bible Church of America (*id.* at 11a, 14a). The Spaeths continued to reside in the property following this transfer, without the payment of rent (*id.* at 13a). On July 14, 1980, the IRS made an income tax assessment against the Spaeths for tax year 1977 in the amount of $3,380 (*id.* at 12a). A notice of federal tax lien reflecting that assessment was filed with the Stearns County Recorder on August 31, 1981 (*ibid.*).

On or about November 20, 1980, a Minnesota corporation called BBCA, Inc. (BBCA) was formed (Pet. App. 11a).[1] On December 30, 1980, Joan Noske, as trustee of Chapter 7024 of the Basic Bible Church of America, quitclaimed the Spaeth residence to BBCA (*ibid.*). On September 18, 1984, the IRS filed a notice of tax lien relating to the assessment against the Spaeths for tax year 1977, asserting that BBCA was a nominee of the Spaeths (*id.* at 12a). Five weeks later, on October 24, 1989, petitioner Xemas, Inc., a Minnesota corporation, was formed (*id.* at 11a). On November 28, 1984, title to the Spaeth residence

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[1] During the years 1978-1980, the veterinary clinic that employed Imelda Spaeth as a bookkeeper sent her paychecks to Chapter 7991 of the Basic Bible Church of America, and no taxes were withheld from her wages based on her claimed exemption from withholding as a "minister." Beginning in 1981, her employer paid Imelda Spaeth's salary directly to BBCA. Under this arrangement, her employer treated her as an independent contractor from whom taxes should not be withheld. Pet. App. 12a-13a.

was transferred to petitioner (*id.* at 12a). During this entire period, the Spaeths continued to reside in the premises without paying rent (*id.* at 13a).

On February 27, 1985, the IRS made income tax assessments totalling $16,561 against Roman Spaeth for his delinquent 1978-1982 taxes. On February 11, 1986, the IRS made income tax assessments totalling $29,789 against Imelda Spaeth for the taxable years 1978-1981. Notices of federal tax lien were filed with the Stearns County Recorder for those assessments on May 8, 1985, and July 9, 1986. Notices were also filed on July 25, 1985, and on July 9, 1986, asserting that the property belonging to BBCA as the nominee of Roman and Imelda Spaeth was subject to the tax liens for those tax years. Pet. App. 12a.

On July 9, 1986, pursuant to a notice of seizure served that same day, the IRS seized the Spaeth residence by administrative levy to satisfy the Spaeths' assessed 1977-1982 income tax liabilities (Pet. App. 11a). Petitioner received the notice of seizure on July 11, 1986 (*id.* at 15a).

2. Prior to the sale of the seized property, petitioner brought this suit in the United States District Court for the District of Minnesota alleging a claim for wrongful levy under Section 7426 of the Internal Revenue Code.[2] In its original complaint, petitioner sought only to enjoin the sale of the property. Thereafter, on January 7, 1987, the public sale of the property was held as scheduled (Tr. 512). Petitioner subsequently was permitted to amend its complaint to seek as relief the property's value or return (Doc. 26). The government denied that it had wrongfully levied on the property, asserting that it was entitled to foreclose its federal tax lien on the property in satisfaction of taxes due from the Spaeths because they were the true owners of the

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[2] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

property within the meaning of Section 6331(a) of the Code. Pet. App. 8a.

After a four-day bench trial, the district court dismissed the suit (Pet. App. 6a-18a). The court explained that it was "fully satisfied" that the government's seizure of the property was "not wrongful" and that "the series of attempted transfers of title was a sham, devoid of economic substance and a contrived device to defraud the United States of its claim upon the property of the [Spaeths]" (*id.* at 8a). This conclusion rested upon several findings of fact. The court determined that the affairs of petitioner, Chapter 7024 of the Basic Bible Church, and BBCA, Inc. were all controlled and directed by James and Joan Noske to aid and assist the Spaeths in their effort to prevent the United States from collecting income taxes that were and would become due (*id.* at 10a, 13a). The Noskes and the Spaeths sought to achieve this tax avoidance by creating dummy entities, which they controlled, and then transferring title to the Spaeth residence to those entities (*id.* at 9a-10a).

The court then made specific findings with respect to the conveyances at issue. It found that each of the conveyances was made "with an intent on the part of the Spaeths and Joan and Jim Noske to prevent the United States from collecting taxes the Spaeths did and would owe" (Pet. App. 14a). The court also found that each conveyance "had no economic reality * * * [and] was made without fair consideration or reasonably equivalent value" (*ibid.*). The court also found that the conveyances were made at a time when the Spaeths were without assets having a sufficient value to pay the debts they owed the United States and the debts they could reasonably be expected to owe the United States in the future (*ibid.*). And the court determined that there was an understanding between James and Joan Noske and the Spaeths that the Spaeths would continue to have

beneficial use and enjoyment of this property notwithstanding the three conveyances at issue (*id.* at 13a).

Based on these findings, the court determined that the series of conveyances that ultimately vested title in petitioner were all voidable under Minnesota's Uniform Fraudulent Conveyance Act, Minn. Stat. Ann. §§ 513.20 *et seq.* (West 1947),[3] and that this determination established a nexus between the property and the Spaeths sufficient to justify enforcement of the lien to satisfy the Spaeths' tax liability (Pet. App. 15a). The court found that the government was a present creditor of the Spaeths when they conveyed the property to Joan Noske (*id.* at 16a), that the conveyance left the Spaeths without sufficient assets to pay the tax debt they could reasonably be expected to owe in the future (*id.* at 14a), that none of the conveyances was made for consideration (*id.* at 17a), and that each conveyance either rendered or kept the Spaeths insolvent (*ibid.*). The court also concluded that petitioner was an alter ego of the Spaeths and, accordingly, that petitioner was not a "purchaser for fair consideration without knowledge of the fraud at the time of the purchase" within the meaning of the Minnesota statute (*ibid.*).

The district court also rejected petitioner's procedural claims. The court held that the IRS was not required to wait until it had adjudicated a fraudulent conveyance claim and received a judgment against the Spaeths before it could levy upon the property (Pet. App. 17a). The court also held that Minnesota's statute of limitations on bringing a suit alleging a fraudulent conveyance did not bar the government from raising the question of fraudulent conveyance defensively in the wrongful levy action (*ibid.*). And the court

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[3] This statute was repealed in 1987 and replaced with a new uniform fraudulent conveyance statute, Minn. Stat. Ann. §§ 513.41-513.51 (West Supp. 1990). See 1987 Minn. Laws ch. 19.

rejected petitioner's claim that it was denied a right to pre-seizure judicial review, explaining that the IRS was not required to issue a notice of deficiency to petitioner concerning the Spaeths' tax liability. Finally, the district court held that the levy did not violate due process because petitioner was given notice of the seizure and had an adequate post-seizure remedy available in the wrongful levy suit (*id.* at 18a).

The court of appeals affirmed "for the reasons given in the opinion of the able District Judge" (Pet. App. 1a-3a).

ARGUMENT

The courts below correctly rejected petitioner's contention that the levy in this case was wrongful. Petitioner does not allege that the decision below conflicts with a decision of another court of appeals, and it is fully consistent with the decisions of this Court. Accordingly, there is no reason for further review.

1. Petitioner's primary contention (Pet. 4-8) is that the government's levy was barred by Minnesota's six-year statute of limitations on setting aside fraudulent conveyances (see Minn. Stat. Ann. § 541.05, subd. 1(6) (West 1988)) because the Spaeths' original conveyance of the property to Joan Noske, as trustee, occurred more than six years before the seizure.[4] This contention is without merit.

The government's levy was executed under authority conferred by Congress in the Internal Revenue Code. It is well recognized that the United States is not bound by state

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[4] The Minnesota statute of limitations begins to run not from the conveyance itself, but rather from the time the creditor "discover[s] • • • the facts constituting the fraud." Minn. Stat. Ann. § 541.05, subd. 1(6) (West 1988). Thus, even if, contrary to our submission, the statute of limitations were applicable here, it is not apparent that the six-year period had expired.

statutes of limitations or subject to the defense of laches in enforcing federal rights. See, *e.g.*, *United States* v. *Summerlin*, 310 U.S. 414, 416 (1940); *United States* v. *Wurdemann*, 663 F.2d 50, 51 (8th Cir. 1981); *United States* v. *Fernon*, 640 F.2d 609, 612 (5th Cir. 1981). The duration of the government's authority to levy on property is instead determined by the specific federal statute of limitations that Congress has established. Section 6321 of the Code provides for the imposition of a tax lien in favor of the United States "upon all property and rights to property" belonging to a delinquent taxpayer. Section 6322 of the Code generally provides that the tax lien arises in favor of the United States upon assessment and continues until the liability is satisfied or the lien becomes unenforceable by reason of lapse of time. Section 6331 of the Code authorizes collection of a taxpayer's delinquent tax "by levy upon all property and rights to property * * * belonging to such person or on which there is a lien * * *." Section 6502 of the Code prescribes the relevant time limitation—authorizing the government to collect a tax debt by levy if the levy is begun (*i.e.*, if the notice of seizure is given) within six years of assessment. The levy in this case was timely under this framework established by Congress (because all assessments against the Spaeths were made less than six years before the notice of seizure was given on July 9, 1986), and therefore the courts below properly found that the levy was not wrongful. See also *United States* v. *Fernon*, 640 F.2d at 611-612 & n.7.[5]

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[5] Petitioner's contention (Pet. 6) that the decision below conflicts with this Court's decisions in *Wilson* v. *Garcia*, 471 U.S. 261 (1985), and *DelCostello* v. *Teamsters*, 462 U.S. 151 (1983), is misconceived. Those decisions, which involved suits brought by private parties, merely stated the "settled practice" that a state statute of limitations may be adopted as federal law "[w]hen Congress has not established a time limitation for a federal cause of action." *Wilson*, 471 U.S. at 266; see also

Moreover, the decision below stands independent of the Minnesota fraudulent conveyance statute. Although a taxpayer may seek to reduce his taxes by any lawful means, it is well settled that a transaction will not be given effect if that form does not coincide with economic reality and is, in effect, a sham. See, *e.g.*, *Knetsch* v. *United States*, 364 U.S. 361 (1960); *Gregory* v. *Helvering*, 293 U.S. 465 (1935). As this Court stated in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945):

> The incidence of taxation depends upon the substance of a transaction. * * * To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

With respect to tax matters, "transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration." *Higgins* v. *Smith*, 308 U.S. 473, 476 (1940). Hence, this Court has recognized that if the title holder of property is the alter ego of the taxpayer, the IRS can "properly regard [the title holder's] assets as [the taxpayer's] property subject to the lien under § 6321, and the Service would be empowered, under § 6331, to levy upon assets held in [the title holder's] name in satisfaction of [the taxpayer's] income tax liability." *G.M. Leasing Corp.* v. *United States*, 429 U.S. 338, 351 (1977) (citing *Griffiths* v. *Commissioner*, 308 U.S. 355 (1939)).

Based on evidence adduced at trial, the district court correctly concluded (Pet. App. 8a) that "the series of attempted transfers of title was a sham, devoid of economic substance

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DelCostello, 462 U.S. at 158. Here, the federal government is enforcing a federal right for which Congress *has* established a statute of limitations, and there is no justification for limiting that right by reference to a state law rule.

and a contrived device to defraud the United States of its claim upon the property of the taxpayers." Since those transactions were shams, the property levied upon belonged to the Spaeths for federal tax purposes, and the government was entitled to levy upon it to satisfy their tax liabilities, without regard to the state's fraudulent conveyance statute.[6]

2. Petitioner also contends (Pet. 8-12) that, regardless of the true ownership of the property, the government lacked authority to seize the property without a judicial order or, alternatively, unless it proceeded under either the Minnesota fraudulent conveyance statute, the Code's jeopardy assessment procedure (I.R.C. § 6861), or its transferee liability provisions (I.R.C. §§ 6901-6902).

The Code provides the IRS with authority to levy on property of the delinquent taxpayer. I.R.C. § 6331(a). Although this procedure involves a seizure without a judicial order, this Court has recognized that the interests of third parties are sufficiently protected through the post-seizure wrongful levy proceeding. See *United States* v. *National Bank of Commerce*, 472 U.S. 713, 729 (1985). Here, the court determined in that proceeding that petitioner, who held the

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[6] There is no justification for petitioner's assertion that this decision has "extraordinary national significance" (Pet. 5) because it will cause uncertainty in the real estate market. Both Minnesota and federal law protect a good faith purchaser for value without notice. See Minn. Stat. Ann. § 513.48(a) (West Supp. 1990); I.R.C. § 6323(a). The decision in this case rested in part on the district court's conclusion (Pet. App. 17a) that petitioner did not qualify for this protection. That conclusion was supported by several of the court's findings, which are not challenged here: the conveyance to petitioner was without fair consideration or reasonably equivalent value (*id.* at 14a); it was made with the intent on the part of the Spaeths and the Noskes to prevent the United States from collecting the Spaeths' taxes (*ibid.*); petitioner was merely the alter ego of the Noskes and the Spaeths (*id.* at 17a); and notices of tax lien, identifying all property of BBCA as subject to the Spaeths' tax lien, had been filed before the conveyance to petitioner (*id.* at 12a).

title, was merely an alter ego of the Spaeths because they, along with the Noskes, completely controlled petitioner. Moreover, the court also determined that the conveyances of the property from the Spaeths to other parties were shams. Accordingly, the Spaeths had an interest in their residence that permitted the government to levy upon that property. See *G.M. Leasing Corp.* v. *United States*, *supra*.

Petitioner's contention that the government was required to proceed by some different method misapprehends the function of the administrative levy. It is a provisional remedy that does not finally determine the relative rights or interests of any competing claimants to the property seized. See *United States* v. *National Bank of Commerce*, 472 U.S. at 728. The administrative levy allows the government to obtain immediate possession of property (including property that on its face belongs to a third party) in which a taxpayer is believed to have an interest—to protect the government against loss while competing claims are resolved in the post-seizure proceedings afforded by the Code. *Id.* at 728-731. Congress has expressly provided that a third party who claims an interest in the seized property may challenge the seizure through either administrative review (I.R.C. § 6343) or judicial review (I.R.C. § 7426). See 472 U.S. at 731. The administrative levy procedure adequately protects the interests of third parties, and the government is entitled to invoke it where the prerequisites of Section 6331(a) are satisfied, notwithstanding the existence of other possible methods of proceeding. See also *Culligan Water Conditioning* v. *United States*, 567 F.2d 867, 870 (9th Cir. 1978) (transferee liability provision of I.R.C. § 6901 is not mandatory where applicable; it is merely one of the IRS's collection methods).

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

KENNETH W. STARR
Solicitor General
SHIRLEY D. PETERSON
Assistant Attorney General
WILLIAM S. ESTABROOK
LINDA E. MOSAKOWSKI
Attorneys

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